Montecito Bank & Trust®
Wealth Management

NOVEMBER 2017 IN REVIEW

December Update | As of November 30, 2017

Economy:

NOVEMBER DATA POINTS TO ACCELERATING GROWTH

Economic Data

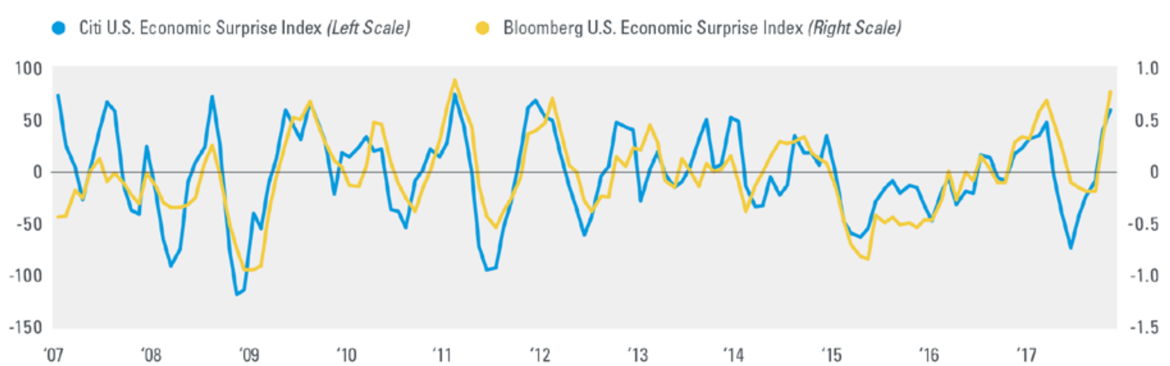
Economic reports released in November 2017, which mostly reflect economic activity in October, largely exceeded economists' consensus expectations with several very strong reports pointing to potential acceleration. With the help of a bounceback in economic activity disrupted by Hurricanes Harvey and Irma, October industrial production and housing data were particularly strong. November economic reports suggest an economy on a growth path modestly higher than the expansion average of 2.2% with few signs of the kind of overheating that could lead to recession. The Bloomberg-surveyed consensus estimates for fourth quarter gross domestic product (GDP) growth stood at 2.7% as of the end of the month.

The Chicago Fed National Activity Index, an aggregate of over 80 monthly indicators, provides one measure of the month's overall strength. The index rose to 0.65 in October (numbers above zero indicate above-trend growth), the strongest single month since January 2012. Overall strength in October was supported, in part, by a solid pickup in industrial production, especially in the manufacturing sector. Overall industrial production rose 0.9% in October, ahead of consensus estimates of 0.5%, while manufacturing production rose 1.3%. The Federal Reserve (Fed) estimated that without the pickup from hurricane-suppressed activity levels industrial production would have risen only 0.3%, but even then the consensus estimate had factored in a much smaller bounceback. The positive overall picture of economic growth also gained support from an upward revision of third quarter GDP from 3.0% to 3.3%, helped by stronger business spending data than originally estimated.

Consumer-oriented reports were mixed in November. October job growth disappointed with 261,000 jobs added to the economy versus expectations of 313,000. October retail sales met modest expectations, rising 0.2%, after a hurricane-influenced 1.9% surge in September. Consumer sentiment remained elevated. The University of Michigan survey for November fell slightly from October's level but remains near its expansion high, while the Conference Board's survey rose for the fifth consecutive month to a 17-year high.

Overall, the economy has continued to grow faster than economist expectations. The Citi U.S. Economic Surprise

ECONOMIC SURPRISE INDEXES SUGGEST UNEXPECTED STRENGTH



Source: LPL Research, Bloomberg, Citigroup Global Markets 11/30/17

Index, a standardized average of economic data compared to economist expectations, rose to its highest level since January 2014 in November. Bloomberg's Surprise Index, which uses a longer moving average and therefore responds more slowly, rose to its highest level since March 2011. The steady stream of net positive surprises was due to data breaking to the upside as well as somewhat muted expectations due to increased economic uncertainty related to Hurricanes Harvey and Irma. Surprises continue to be more skewed toward survey-based "soft" data, but surprises based on measures of actual economic activity ("hard" data) continue to improve.

Indicators that tend to lead economic activity suggest steady growth is likely to extend into 2018. The Conference Board's Leading Economic Index (LEI), an aggregate of 10 leading indicators, rose sharply in October, with 9 of the 10 individual components making a positive contribution in October. The year-over-year change of 5.2% is the strongest since May 2015. Positive year-over-year growth has historically been associated with the low chance of a recession in the next year. Strength in leading indicators over the last six months in particular suggests the odds of a recession in the next year remain below the historical average.

Central Banks

The biggest move for central banks in November took place early in the month, when the Bank of England followed through on a widely expected 0.25% rate hike. However, the central bank's post-meeting communications pointed toward a slower path of rate hikes moving forward than many had expected given the potential for Brexit-related headwinds over the next year.

Domestically, the Fed's October 31–November 1 Federal Open Market Committee (FOMC) meeting was uneventful as expected. There was no rate hike in November, but neither the post-meeting statement nor the meeting minutes released on November 22 did anything to reduce the market's high expectations for a rate hike in December. Both also showed that the Fed remained concerned about below-target inflation.

But, the bigger story out of the Fed in November was staffing. President Trump nominated Jerome (Jay) Powell to be the next Fed chair in a press conference on November 2. Shortly thereafter (November 6), William Dudley, president of the New York Fed, a position that is a permanent voting member of the FOMC, announced he will be retiring in mid-2018 to ensure a successor is in place before his term is up in January 2019. Current chair Janet Yellen could have technically remained on the Fed Board until her term expires in 2024, but on November 20, she confirmed she will be stepping down once Powell is installed as chair. Trump nominated Carnegie Mellon University Professor Marvin Goodfriend for one of the currently open slots on the Fed's seven-seat Board of Governors, leaving the Board with three remaining openings.

LEADING INDICATORS CONTINUE TO SIGNAL LOW ODDS OF RECESSION

Source: LPL Research, Conference Board, Bloomberg 11/30/17

Global Equities:

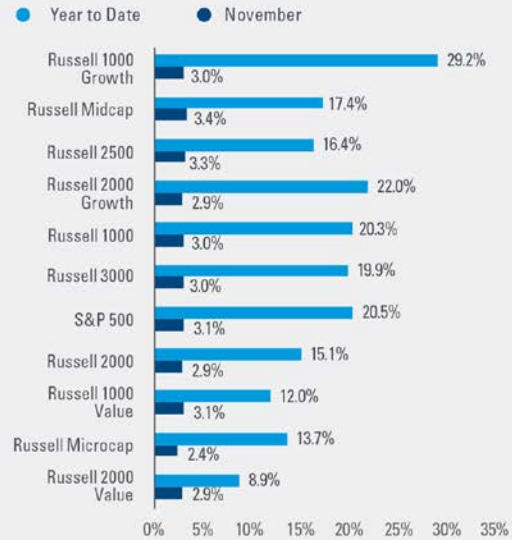
STEADY MARCH HIGHER CONTINUES FOR U.S. STOCKS

The S&P 500 Index returned 3.1% in November to post its eighth straight monthly price gain and record thirteenth straight including dividends. Year to date through November, the S&P 500 has produced an impressive 20.5% return. Should the streak continue through December, it would mark the first time in the S&P 500's history (dating back to 1928*) that the index has produced positive total returns all 12 months in a calendar year. The Dow, which returned 4.2% in November, has produced eight straight monthly gains and a year-to-date return of 25.7%; while the Nasdaq, which gained 2.4% in November, has been higher 12 out of the last 13 months and has returned 29.1% year to date.

November gains were driven by several different factors. First, economic data was solid and mostly above expectations, including the positive revision to third quarter GDP. Data continued to support a robust manufacturing environment, while a strong start to the holiday shopping season provided confirmation of a healthy U.S. consumer. Second, companies reporting third quarter earnings results during November continued to mostly surprise to the upside and provide positive outlooks. And third, throughout the month, markets became more optimistic about tax reform. Specifically, stocks rallied late in the month after news spread of Senator McCain's support, which was followed by reports that a compromise with the few remaining holdouts was likely. As November ended, the path to passage in the Senate had become quite clear, buoying the outlook for corporate profits and investor sentiment.

Sector leadership in November generally tracked the relative benefits of tax policy. Telecommunications, a largely domestic sector that pays high tax rates, topped all sectors for the month with a 6% return. The sector may have also benefited from the proposed addition of a communications sector to the S&P lineup that will include telecommunications, in addition to media and cable companies. The move, expected in September 2018, could attract more interest for the traditional telecommunication names. Consumer staples and consumer discretionary also outperformed the S&P 500, as retailers are poised to be big beneficiaries of tax reform; early results from the holiday shopping season also helped. On the flip side, technology — a sector that

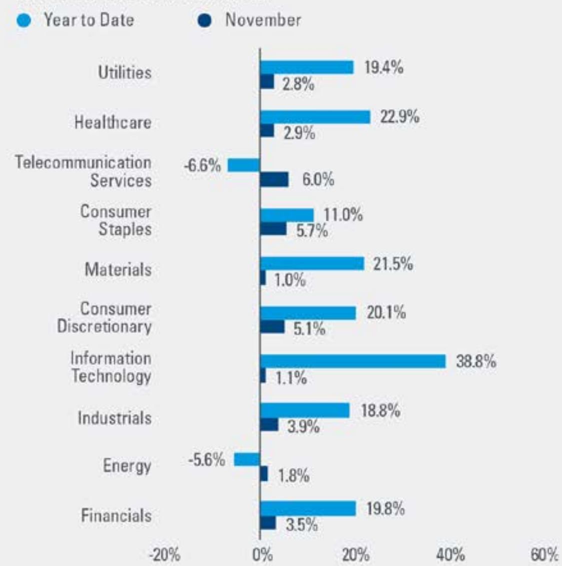
DOMESTIC INDEX PERFORMANCE



Source: LPL Research, FactSet 11/30/17

Indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

S&P 500 SECTOR PERFORMANCE



Source: LPL Research, FactSet 11/30/17

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Stock investing involves risk, including loss of principal.

Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

pays among the lowest tax rates — was among the worst performers, though profit-taking after such strong gains in 2017 likely played a role in the weakness.

The growth and value styles produced similar returns in November, based on the Russell 3000 style indexes. The biggest value sector, financials, outpaced the biggest growth sector, technology. However, growth got a boost from consumer discretionary strength and value was dragged down by energy weakness, leaving the styles in line for the month. Growth has been strongly in favor in 2017, with the Russell 3000 Growth Index returning 28.7%, well ahead of the 11.8% return for the Russell 3000 Value Index.

Small caps produced similar returns as large caps in November but remain behind year to date. After getting a boost in September on improved prospects for tax reform, which generally benefits smaller companies more than large, small caps were unable to gain any ground in October or November, even as Republicans moved closer to Congressional approval. Small caps have returned a very respectable 15.1% year to date, but trail the 20.3% return for large caps based on the Russell indexes.

International

Developed international equities posted gains in November, based on the MSCI EAFE Index, but were unable to keep up with the stronger U.S. equity markets during the month. The 1.1% return for the index in November brought the year-to-date gain to a solid 23.6%. The U.S. dollar's 1.6% decline was a positive driver for U.S.-based investors in overseas equities, but weakness in Europe — despite continued strong regional economic data — offset currency-related gains. In terms of country performance, weakness in the U.K. weighed on the benchmark due largely to bumpy Brexit negotiations. Equities in the Netherlands and Spain also declined. Meanwhile, Japanese equities fared relatively well, as the MSCI Japan Index returned 2.5% for the month.

Despite U.S. dollar weakness and a lack of surprises in global monetary policy, emerging markets equities rose only marginally in November, trailing both U.S. and international developed equity market benchmarks. The MSCI Emerging Markets Index returned just 0.2% for the month, but still leads the major regional equity benchmarks with a 32.9% return year to date. MSCI equity benchmarks for Russia and South Africa outperformed the MSCI EM Index, while those in Taiwan, India, and Brazil lagged.

GLOBAL INDEX PERFORMANCE

Source: LPL Research, FactSet 11/30/17

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International and emerging markets investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors.

Fixed Income:

YIELD CURVE CONTINUES ITS FLATTENING TREND

Treasury yields rose across the majority of the maturity spectrum during November, with shorter maturity yields rising substantially over the month. The 2-year Treasury rose by 18 basis points (0.18%), while the 10-year rose by just 4 basis points (0.04%) — pushing the Treasury yield curve to its flattest level of this economic cycle. Inflation expectations were steady over the course of the month. The markets almost fully priced in a December rate hike, which pressed short-term rates higher. Expectations for rate hikes in 2018 moved higher as well, as tax reform progressed throughout the month, potentially heating up the economy and necessitating more rate hikes than absent tax reform.

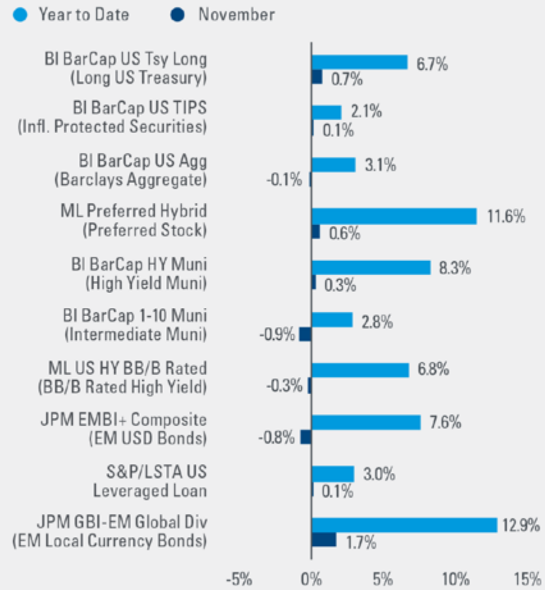
The upward pressure on yields led to a mixed month for high-quality fixed income. The broad Bloomberg Barclays U.S. Aggregate Bond Index lost -0.1% during the month, with all three of its major segments (Treasuries, investment-grade corporates, and mortgage-backed securities) performing in line with the index. Municipal bonds weakened as heavy issuance weighed on the market; issuers rushed to market to get ahead of tax changes that could make certain types of municipal bonds issued after the end of 2017 ineligible for tax-free status.

Preferred securities were the standout performer of the month, returning 0.6%, as tax reform was a tailwind for financial firms, which are heavy issuers within the asset class. Bank loans returned 0.1%, buoyed by rising short-term interest rates.

Investing in foreign and emerging markets debt securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards.

Municipal bonds are subject to availability, price, and to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply.

FIXED INCOME PERFORMANCE



U.S. TREASURY YIELDS

Security	10/31/17	11/30/17	Change in Yield
3 Month	1.15	1.27	0.12
2 Year	1.60	1.78	0.18
5 Year	2.01	2.14	0.13
10 Year	2.38	2.42	0.04
30 Year	2.88	2.83	-0.05

AAA MUNICIPAL YIELDS

Security	10/31/17	11/30/17	Change in Yield
2 Year	1.07	1.32	0.25
5 Year	1.44	1.62	0.18
10 Year	2.12	2.21	0.09
20 Year	2.77	2.79	0.02
30 Year	2.95	2.95	0.00

Source: LPL Research, Bloomberg, FactSet 11/30/17

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Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.

Bank loans are loans issued by below investment-grade companies for short-term funding purposes with higher yield than short-term debt and involve risk.

Alternatives:

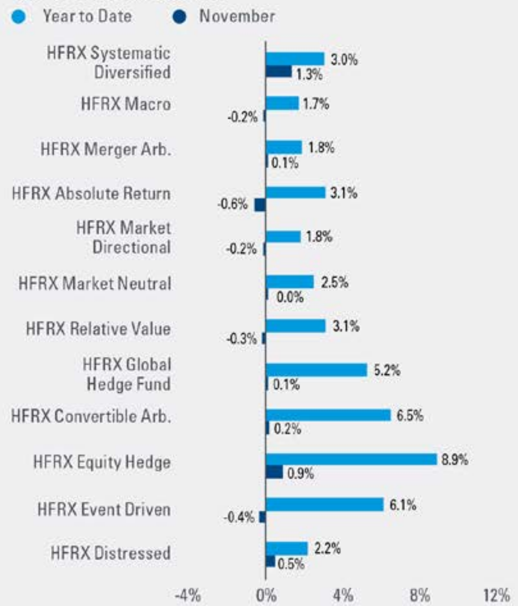
LONG/SHORT PERFORMANCE IMPACTED BY SECTOR ROTATION

The HFRX Equity Hedge Index returned 0.9%, trailing the 3.1% S&P 500 gain on both an absolute and risk-adjusted basis. Long positions delivered positive returns, however, the industry's growth tilt, specifically an overweight to information technology stocks, acted as a headwind due to the relative underperformance of the sector. Short exposure detracted from overall returns, predominantly due to consumer staples and telecommunication firms increasing in value. This factor rotation away from firms whose share prices have experienced strong momentum also impacted strategies within the HFRX Market Neutral Index, which was marginally positive for the month.

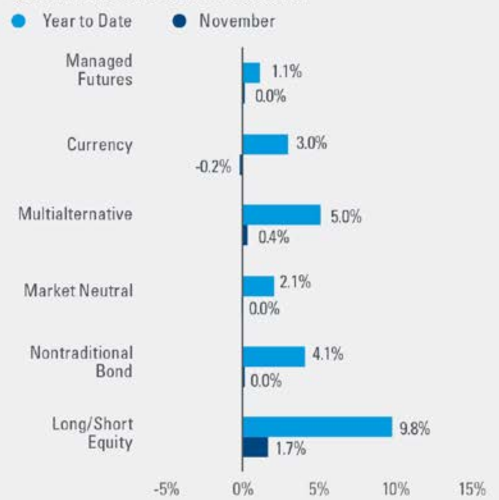
The HFRX Systematic Diversified Index gained 1.3%, as strength within domestic equity markets continued to drive performance. Year to date, the index has now returned 3.0%. While global equity exposure has been the most consistent and largest component of most managed futures models, we've seen a moderate reduction in net equity exposure due to weakness in certain Asian and European markets. Returns within the currency, fixed income, and commodity markets were generally muted, with the exception of long crude oil exposure delivering additional gains.

The HFRX Event-Driven Index declined 0.4%, while subcategory performance was mixed. Broad strength across the credit spectrum has limited the opportunity set within the distressed debt investing space (HFRX Distressed up 0.5% for the month and 2.2% year to date); while common existing positions such as Puerto Rican municipal debt and European non-performing loans have yet to fully develop. The HFRX Merger Arbitrage Index gained 0.1%, as legislative progress on tax reform and greater clarity on the end form continue to occupy the interest of most strategies.

HFRX INDEX PERFORMANCE



MORNINGSTAR INDEX PERFORMANCE



Source: LPL Research, FactSet 11/30/17

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Alternative strategies may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

REAL ASSETS: SOLID REIT PERFORMANCE IN OVERALL MIXED MONTH

November was another mixed month for liquid real assets. Domestic and international real estate and global infrastructure produced gains, while commodities and master limited partnerships (MLP) experienced losses.

MLPs

The struggles for MLPs continued in November despite higher oil prices. November's 1.4% decline brought the year-to-date loss for the Alerian MLP Index to 10.8%. A number of factors contributed to the weakness, including slowing distribution growth prospects, as the industry increasingly focuses on balance sheet strength and sustained cash flow growth to help reduce reliance on the capital markets. Concerns about potential adverse effects of tax reform and year-end tax loss selling also weighed on the group during the month.

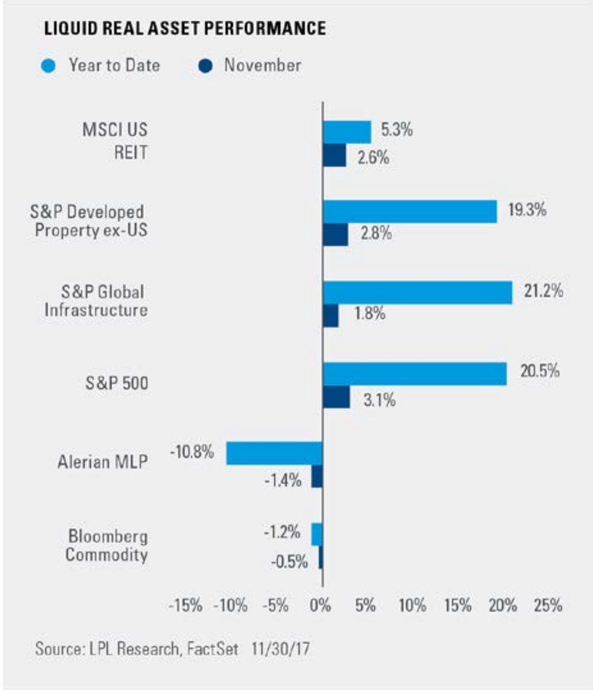
REITs & Global Listed Infrastructure

In November, domestic REITs posted their strongest monthly return since February 2017, but the asset class still modestly underperformed the broad equity market for the month and has done so year to date. Data centers remain this year's top-performing real estate subsector after another strong month. For the first time this year, retail was the top-performing subsector for the month, but it remains the worst performer year to date.

The S&P Global Infrastructure Index produced a gain but underperformed the broad equity market for the second straight month, shrinking the asset class's year-to-date outperformance relative to global equities. The impacts of rising interest rates and central bank tightening, albeit gradual, partly offset currency benefits.

Commodities

The Bloomberg Commodity Index dipped 0.5% in November, as higher oil prices only partly offset weakness in industrial metals. Oil's 5.5% rally was driven by a combination of factors, including the extension of the OPEC-led production limits through year-end 2018, improving global growth prospects, drawdowns in domestic inventories, and geopolitical tensions. Industrial metal prices, notably copper, fell during the month amid concerns about China's growth outlook and its expanding refinery capacity. Precious metals were down marginally as slightly higher interest rates and the market's preference for riskier assets offset the benefit of a weaker U.S. dollar. Within agriculture, gains in cotton and sugar helped counterbalance losses in grains and livestock.



Investing in real estate/REITs involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained.

Investing in MLPs involves additional risks as compared with the risks of investing in common stock, including risks related to cash flow, dilution, and voting rights.

MLPs may trade less frequently than larger companies due to their smaller capitalizations, which may result in erratic price movement or difficulty in buying or selling. MLPs are subject to significant regulation and may be adversely affected by changes in the regulatory environment, including the risk that an MLP could lose its tax status as a partnership. Additional management fees and other expenses are associated with investing in MLP funds.